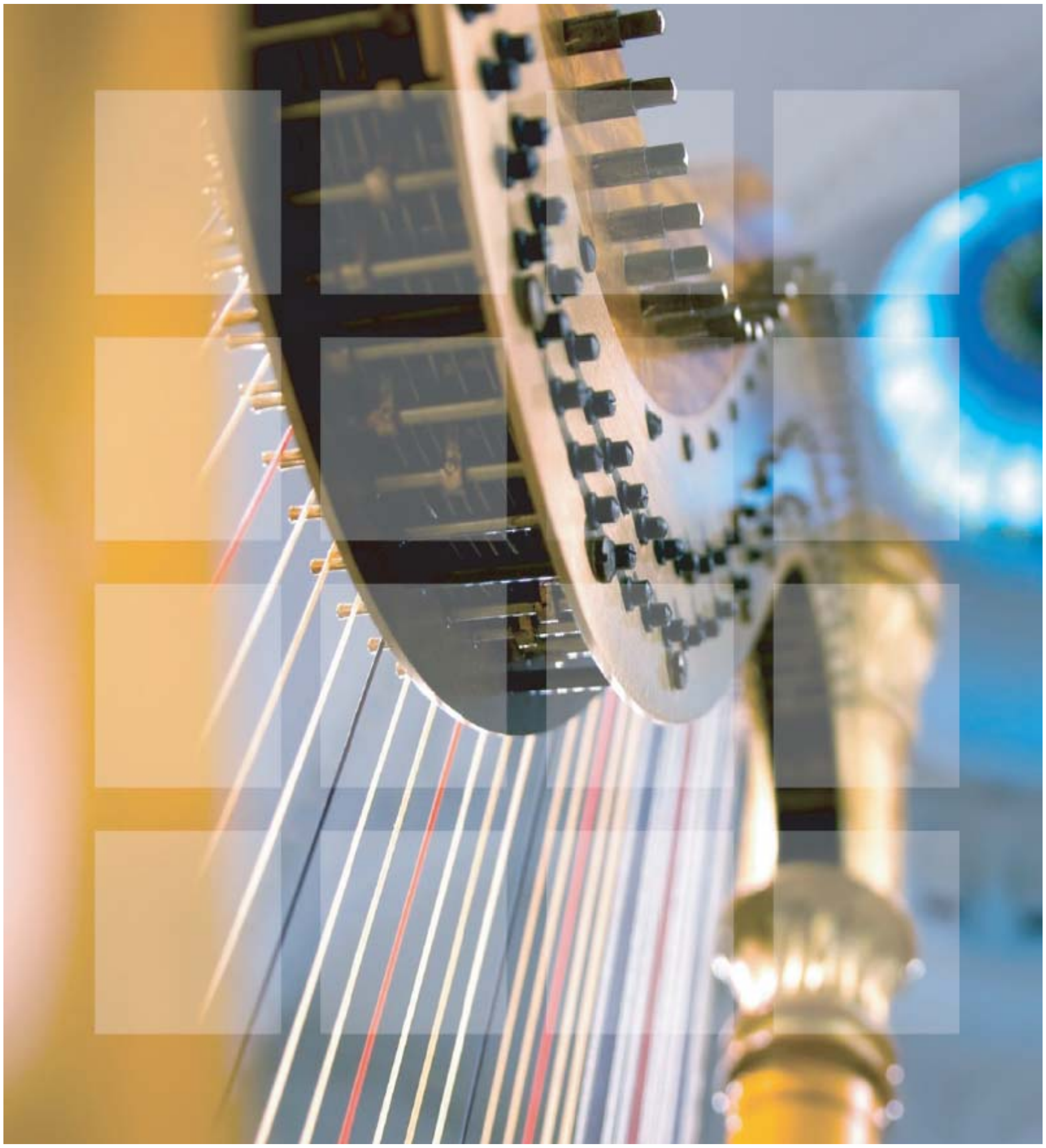

DEPARTMENT OF FINANCE

Report of the Regional Meetings on Credit Supply
Chaired by Minister for Small Business Mr John Perry T.D.
Addressed by Secretary General Mr John A Moran

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Executive Summary

The unprecedented crisis in the Irish banking sector allied to a severe economic contraction has created a difficult and complex environment for SMEs seeking to access finance. Following recapitalisation in 2011, the banks maintained that they were willing to lend to viable businesses, while the business community was adamant that the banks were not lending.

Faced with these claims and to establish certainty as to the situation on the demand side, in October 2011 the Department of Finance commissioned Mazars to carry out an independent survey of over 1,500 small and medium enterprises (SMEs) to ascertain the situation in relation to the demand for credit from SMEs.

On foot of the Mazars report, and in order to understand the situation "on the ground" as well as stimulating further ideas to get movement from the bottom up, a series of seven regional meetings with local representatives, including the banks and small business representatives, was undertaken, hosted by the Minister for Small Business, John Perry T.D., supported by Mr John Moran, Secretary General in the Department of Finance. The aim of these meetings was to examine further the actions which might be taken to improve access to credit for SMEs.

There were robust discussions at these meetings around the issue of credit and, although not every problem was solved, action points arose following each of the meetings which necessitated further engagement from the stakeholders.

This report outlines the issues raised at each of the meetings along with the resultant action points, as well as examining a number of issues requiring further consideration:

- **Credit Review Office** – Why are the numbers availing of this service so small?
- **Agricultural Lending** – Have banks the expertise and the right products to lend to young small farmers?
- **Hotels** – Is there a need for Government intervention or would this distort the market further?
- **Legacy debt** – Is there a case for banks to introduce "split mortgages"?

- **Non-bank finance** – Given the ongoing tightening of capital adequacy requirements being placed on banks, including those contained in Basle III, what can be done to create an environment which encourages a greater emphasis on non-bank forms of funding for the SME sector?

Background to Regional Meetings

Faced with conflicting claims by both sides of the debate as to whether or not banks were lending and to establish certainty as to the situation on the demand side, in October 2011 the Department of Finance commissioned Mazars to carry out an independent survey of over 1,500 small and medium enterprises (SMEs) to ascertain the situation in relation to:

- the demand for credit from SMEs;
- their level of knowledge on their rights in relation to credit;
- the reasons given for refusal of credit and;
- the failure of SMEs to seek credit.

The sample size was double the generally accepted robust sample size of 750 respondents. The purpose of the survey was to provide data on the demand for credit by SMEs in the period April-September 2011. The Department had no specific interest in the individual financial affairs of any of the SMEs that participated in this survey.

On foot of the Mazars report, a series of seven regional meetings with local representatives was undertaken, hosted by the Minister for Small Business, John Perry T.D., supported by Mr John Moran, Secretary General in the Department of Finance, the aim of which was to examine further the actions which might be taken to improve access to credit for SMEs.

Background to Credit Conditions Facing SMEs

Setting the Scene

The unprecedented crisis in the Irish banking sector allied to a severe economic contraction has created **a difficult and complex environment for SMEs seeking to access finance.** Initially Ireland's economic downturn was characterised by a slowdown in credit growth, and since 2009 the outstanding level of credit to the private sector has fallen. To a considerable degree, the fall in credit is an inevitable part of Ireland's economic adjustment; indeed reduction in outstanding debt is a central feature of the economic adjustment of the world economy. Across the OECD the financial and economic crises have had a strongly negative impact on the real performance of SMEs with output, sales, employment and exports all adversely impacted in the period 2008-09.[1]

In the wake of this crisis, **the financial situation of SMEs broadly deteriorated and the OECD notes that in most countries loans to SMEs declined markedly.**[2] Although there has been some improvement lending to SMEs remains below the pre-crisis levels. The most recent results from the ECB Survey of SME Access to Finance confirm that SMEs continue to face problems in accessing finance.[3]

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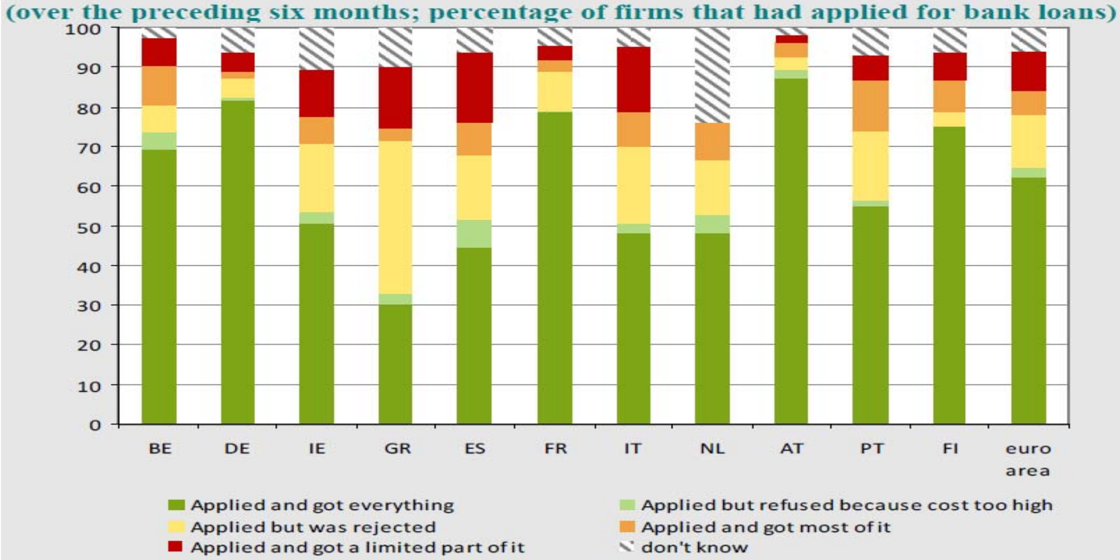
[1] OECD (2012) Financing SMEs and Entrepreneurs: An OECD Scoreboard, Paris: OECD

[2] Ibid.,

[3] ECB (2012) Survey on the access to finance of small and medium-sized enterprises in the Euro area, April 2012 available at http://www.ecb.europa.eu/stats/money/surveys/sme/html/index.en.html

OUTCOME OF APPLICATIONS FOR BANK LOANS BY SMES ACROSS EURO AREA COUNTRIES

(over the preceding six months; percentage of firms that had applied for bank loans)



Firms that applied for a bank loan (new or renewal; excluding overdrafts and credit lines) (over the preceding six months; percentages)

Banks and the Provision of Credit

The key source of funding of SMEs and enterprise in general in Ireland is the banking system. In March 2011, the two pillar banks, Allied Irish Bank and Bank of Ireland accounted for 63% of outstanding SME lending in Ireland and they along with the Ulster Bank are likely to dominate new lending.

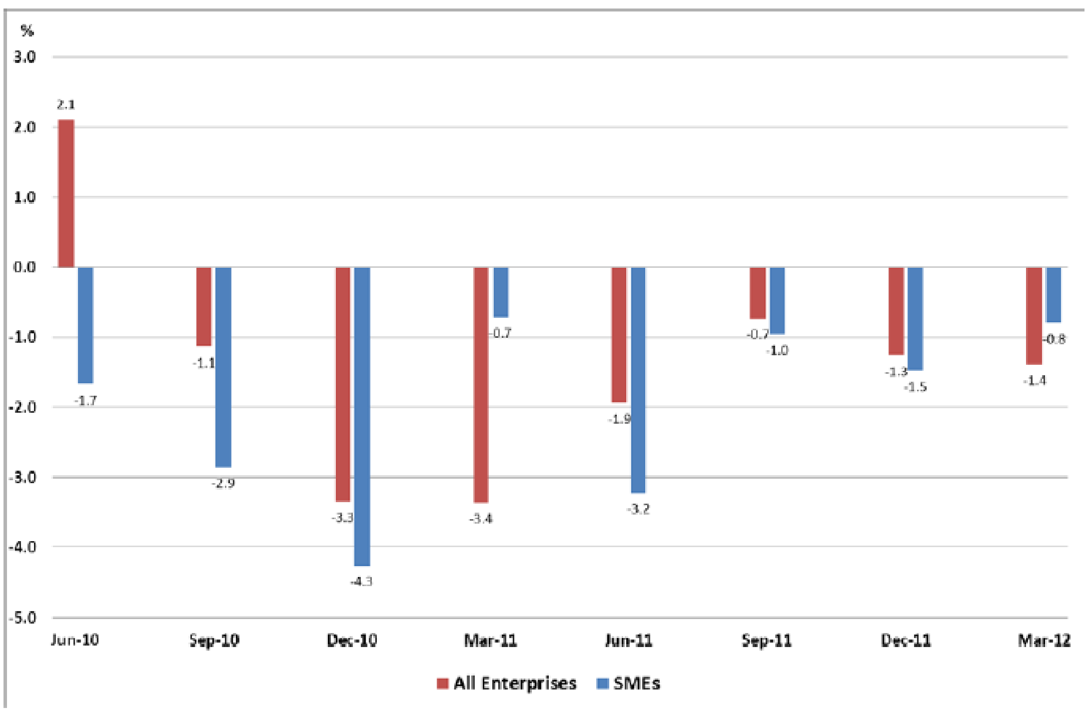
In terms of the provision of credit to SMEs, it is now clear that up to 2008 the conditions attached to the application of loans to SMEs were not sufficiently robust and as a result credit was granted to some non viable businesses or on non-viable terms and conditions. The banks have correctly since upped their standards in terms of credit applications, but are we now in a situation where credit is at an appropriate level or are the banks playing it too "safe", thereby hindering economic growth? In relation to credit supply, **the constant dilemma is to ensure that despite contracting demand the supply of credit is always sufficiently more robust, even during periods of economic difficulty.**

Is there a demand side issue, whereby businesses who had no problem obtaining credit in the boom years with lax underwriting standards are reacting negatively to the higher standards demanded of them in credit applications?

Clearly, it is vital that the banks continue to make credit available to support economic recovery. However, **it is not in the interest of the banks, businesses or the economy for finance to be provided unless the business is viable** and has the capacity to meet the interest payments and repay the sum borrowed.

The fall in credit supply (Figure 1 below) would however raise the concern that the pendulum may have swung too far in the opposite direction.

Figure 1: Quarterly Rates of Change in Credit Advanced to All Irish Private-Sector Enterprises and SMEs (excl. financial intermediation and property-related sectors) (Source: Central Bank: Trends in Business Credit and Deposits: Q1 2012)



Legacy Property Issues

Another factor peculiar to Irish businesses is the overhang of property debt. Many viable businesses exhausted working capital built up in good times by investing in property, in many cases unrelated to the business, the loans for which were based on personal guarantees. As many of these investments are now significantly underwater in negative equity, **the SME owners are having difficulty in accessing loans for working capital purposes for the business as the banks are faced with an over indebted borrower and a business in a weak economic cycle.**

If an otherwise viable business has difficulty servicing "unrelated" mortgage repayments, **one solution could be that banks be more inventive and flexible, and assist in devising a suitable cashflow repayment structure**, such as splitting the loans to release the business from the pressure of property repayments until the business can recover.

Cost of Funding

The cost of funding has increased throughout Europe, and Ireland and its banks are particularly exposed to potentially higher costs as a peripheral nation. Interest rates are determined by a broad range of factors including ECB base rates, deposit rates, market funding costs, the competitive environment, and an institution's overall funding.

There have been numerous calls for the Government to intervene to ensure that banks pass on ECB interest rate decreases to customers. The Financial Regulator, Mr Matthew Elderfield, has indicated that experience of such controls in the past and in other countries does not encourage the Central Bank to believe that such a regime would be advantageous in net terms as the banking system recovers its normal functioning. **Binding controls tend to reduce availability of credit and channel it to the most creditworthy customers, starving smaller and less secure customers from credit.** The Regulator indicates that this could have a chilling effect on the entry of sound competitors into the market. By absolving banks from their responsibility to price risk accurately, binding interest rate controls would, especially during this recovery phase, impede progress towards the re-establishment of bank management practices that can ensure a healthy and free-standing banking system no longer dependent on the Government for bail-outs.

Further analysis would be welcome on the appropriateness or not of the current pricing structure, taking into account all factors such as the loss of deposits, existence of ECB LTRO, low point in economic cycle and the accordingly weak underwriting covenant of many businesses.

Government Policy

One of the key priorities of the Programme for Government is to ensure that an adequate pool of credit is available to fund small and mediumsized businesses (SMEs) in the real economy during the re-structuring and down-sizing programme. The Government has introduced a number of policy tools to achieve this objective:

- The banking system restructuring plan creates capacity for the two Pillar Banks, Bank of Ireland and AIB, to **provide lending in excess of €30 billion from 2011 to 2013**. SME and new mortgage lending for these banks is expected to be in the range of €16-20bn over this period. This lending capacity is incorporated into the banks' deleveraging plans which allow for repayment of Central Bank funding through asset run-off and disposals over the period.

- The Government has imposed **lending targets on the two domestic pillar banks** for the three calendar years, 2011 to 2013. Both banks were required to sanction lending of at least €3 billion in 2011, €3.5 billion this year and €4 billion in 2013 for new or increased credit facilities to SMEs. Both banks achieved their lending targets for 2011. The amount of credit advanced by the banks to SMEs is dependent on two separate aspects of the credit application process, the volume and value of requests for credit which is the demand side and the level of approvals made by the banks in response to requests for credit which is the supply side. The banks have control over the supply side but are not in a position to control the demand side. Once the bank has granted approval for the credit application, it is a matter for the borrower to decide when or if they want to avail of the credit approved. Therefore, the lending targets are based on credit sanctions rather than drawdowns.

- In addition to the lending targets imposed on the banks, the pillar banks are required to **submit their lending plans** to the Department of Finance and the Credit Review Office (CRO) at the beginning of each year, outlining how they intend to achieve these lending targets. The banks also meet with the Department and the CRO on a quarterly basis to discuss progress.

- It is important to note that the **Relationship Frameworks** with the banks provide that the State will not intervene in the day-to-day operations of the banks or their management decisions including with respect to pricing and lending decisions. These frameworks are published on the Department of Finance website at http://banking.finance.gov.ie/presentations-and-latest-documents/ .

- The CRO is available to review cases where **credit facilities up to €500,000** are refused, withdrawn, or offered to SMEs with unreasonable conditions. This limit was increased from €250,000 last year on foot of a suggestion contained in the **Credit Suggestions Initiative. The CRO ruled that credit be granted in over 60% of cases it has reviewed, and the banks have complied.**

- A working group has been established consisting of representatives from the Department of Finance, the Central Bank and the Credit Review Office to examine **the relationship between sanctioned lending, "new" money and drawn down facilities**. This will provide clarity to the data illustrating economic activity in the SME sector.

- The Central Bank published a revised statutory **Code of Conduct for Business Lending to Small and Medium Enterprises (SME Code)** setting out new requirements for lenders when dealing with SMEs in, or facing, financial difficulties which came into effect from 1 January 2012. A full review of the SME Code will be undertaken in 2012.

- The **Temporary Partial Credit Guarantee Scheme** aims to provide credit to job-creating SMEs who currently struggle to get finance from the banks. It is intended to address market failure affecting commercially viable businesses in two specific situations – namely, where businesses have insufficient collateral, and where businesses operate in sectors with which the banks are not familiar – and provide a 75% State guarantee to banks against losses on qualifying loans to firms with growth and job creation potential. Initially, the scheme will facilitate up to €150m of additional lending per annum to SMEs, in addition to the lending targets set for the pillar banks. The Scheme will be demand-led, and take-up and performance will be closely monitored. For every €150million of additional lending, the Scheme is expected to benefit over 1800 businesses. The cost of the Scheme per €150million of lending is €6.38million. However this does not take into account benefits to the exchequer this lending will bring in terms of increased tax receipts and decreased social welfare payments. When these benefits are taken into account, the net gain to the Exchequer is over €25million per €150million of lending.

- A **Microfinance Fund** to provide loans to small businesses is also being developed within the Department of Jobs, Enterprise and Innovation, in close consultation with the Department of Finance, for establishment shortly. It is anticipated the Micro Finance Loan Fund will generate up to €100million in additional micro-enterprise lending which will benefit more than 5,000 businesses over a ten year period. The Fund will be established as a subsidiary of Social Finance Foundation (SFF), and will be managed and controlled by SFF on behalf of the Minister for Jobs, Enterprise and Innovation.

- Sharing of information and ideas is key. The first meeting of the reinstated SME Credit Consultation Committee took place on 12 June. **The role of this Committee is to provide a forum where stakeholders can communicate and interact regarding difficulties in relation to SME credit with a view to proactively solving them.** The membership of the Committee will be as follows:

Public Bodies	**Representative Organisations**	**Banking**
D/Finance	ISME	AIB
D/Jobs Enterprise and Innovation	Chambers Ireland	BOI
Forfás	Small Firms Association	Ulster Bank
Enterprise Ireland	IFA	IBF
Fáilte Ireland		

Action Plan for Jobs

In November 2011, the Government committed to completing an annual Action Plan for Jobs that would involve the whole of Government focusing on what part they and their agencies could play in protecting or creating jobs. One of the key components of the Plan is to ensure that viable SMEs can access credit. The actions to achieve this objective include:

- Monitor closely the lending targets for pillar banks and ensure these targets are met, and develop a sharper focus on the "new money" element;
- Engage with stakeholders on the findings revealed in credit supply and demand surveys with a view to identifying and addressing blockages in the system;
- Conduct a follow-up survey on demand for credit from SMEs;
- Assess the Credit Review Office to ensure SMEs are getting the support on bank lending they require.
- Review the equity investment landscape in Ireland with a view to introducing actionable steps (enterprise supports, tax, etc) to support equity investment in productive firms.
- Roll - out the temporary targeted partial credit guarantee scheme, to complement existing initiatives to improve the credit environment and to address specific market failures.
- Work with banks and small business representative organisations to help SMEs improve the quality of loan application.

Highlights of Mazars Survey

• *The demand survey*: The demand survey represents a study of lending to SMEs conducted in Ireland examining the issue of credit availability. It was carried out by a third party specialist firm Ipsos MRBI in conjunction with Mazars. A sample of SMEs were contacted and asked to respond to a phone based questionnaire. This sample was selected from a database of approximately 130,000 companies. The survey was carried out in October 2011 and respondents were asked to respond based on their experience in the previous 6 months.

• *Respondents*: The demand survey analysed the responses of 1,506 SMEs. The responses can be considered to be representative of the population of SMEs and across small, medium and micro SME organisations in economic value terms.

• *Trading conditions*: Survey responses suggest continued difficult trading conditions, in particular for micro and small companies, but this is very pronounced for micro companies. In total, 48% reported a continued decrease in turnover and 17% reported more than 20% decrease. Encouragingly however, 26% of companies also indicated that turnover had increased, largely concentrated in the medium category.

• *Employee numbers*: A levelling off in the rate of decline in employee numbers is also apparent in the 6 months covered by this Report and it would appear that the downward trend in staff levels has started to slow. Whilst increases in employee numbers were in general modest, 75% of companies indicated that staff levels had either remained the same or increased.

• *Consolidation*: More SMEs reported an increase in profit in the last 6 months than a decrease in spite of turnover challenges, suggesting that SMEs have been able to consolidate, adjust or rationalise costs and realign their businesses to the economic environment in which they are operating. 72% have indicated they will break even or make a profit in the period to September 2011.

• *Demand for credit*: 36% of survey respondents made one or more requests for credit during the period of the review, representing a reduction in the demand for credit in the period of approximately 10 percentage points when compared to the previous study carried out by Mazars. Of those requests for credit, 70% of applicants made a formal request (where a customer fills out a formal application form). Only 11% of respondents indicated that they had requested or applied for a non bank form of finance.

• *Bank lending*: On an overall basis 85% of companies attributed their decision not to seek credit to company specific reasons only such as the fact that they did not require credit. 10% of companies indicated that they did not request credit because of bank specific factors only such as their perception that banks were not lending (7%).

1,506

SMEs Surveyed

Apr 11 – Sep 11

Period Covered by Survey

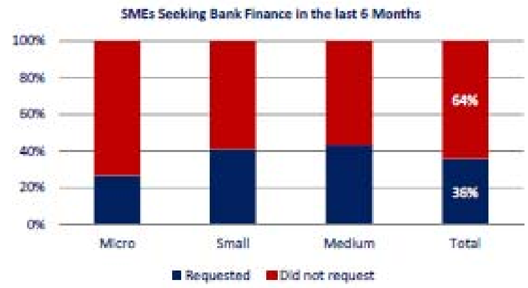
Demand

36%

Requested Bank Credit

64%

Did not Request Bank Credit



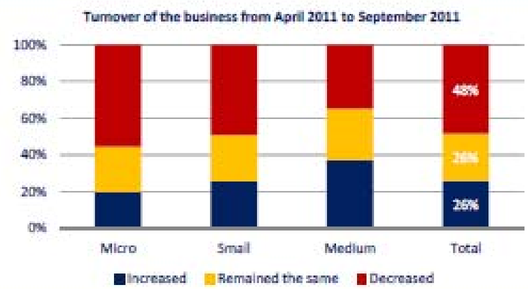
Trading Performance

26%

Reported an increase in turnover

48%

Reported an decrease in turnover



Application Decisions

54%

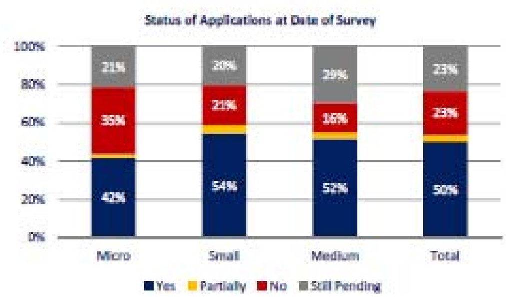
Approved or partially approved

23%

Declined

23%

Pending or awaiting assessment



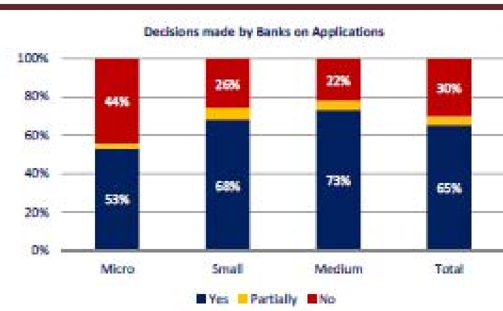
Application Decisions (excluding pending)

70%

Approved or partially approved

30%

Declined



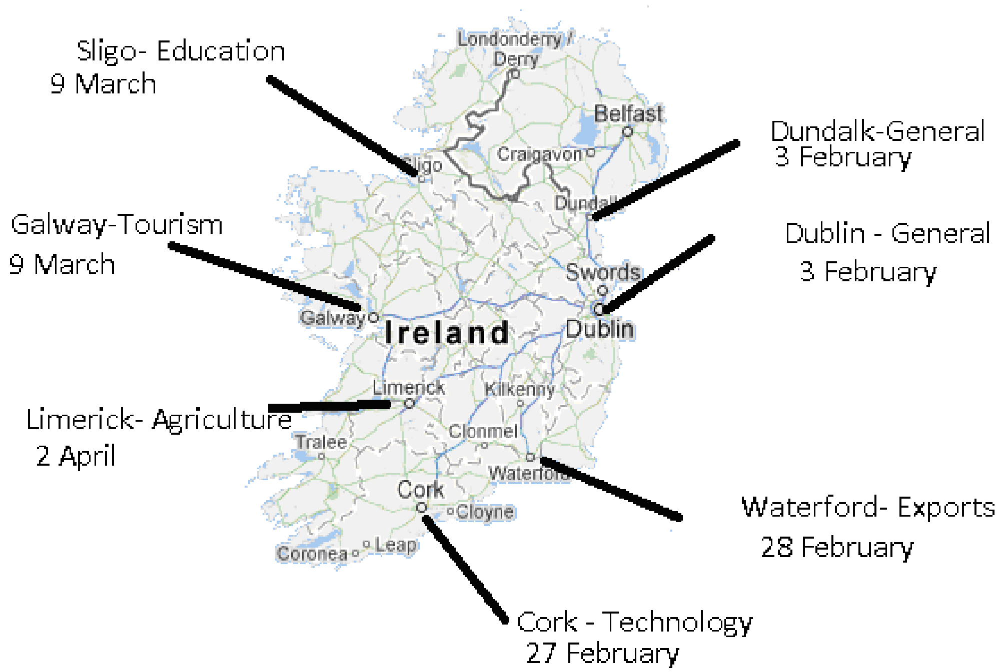
The Regional Meetings

On foot of the Mazars report, and in order to understand the situation "on the ground" as well as stimulating further ideas to get movement from the bottom up, a series of seven regional meetings with local representatives was undertaken, hosted by the Minister for Small Business, John Perry T.D., supported by Mr John Moran, Secretary General in the Department of Finance. The aim of these meetings was to examine further the actions which might be taken to improve access to credit for SMEs. The invitation list for the meetings was as follows:

- A regional representative of SFA;
- A regional representative of ISME;
- A representative of each Chamber in the region;
- A regional representative of Vintners Federation of Ireland;
- A representative of Licensed Vintners Association;
- A regional representative of Retail Excellence Ireland;
- A representative of local CCEBs;
- A representative from each of Dept of Transport, Tourism & Sport and D/JEI;
- Local members of the Advisory Group on Small Business;
- A regional representative of Fáilte Ireland and ITIC;
- A regional representative of IFA;
- Regional representatives of the three main banks;
- A regional representative of Enterprise Ireland;
- A regional representative of IDA and Forfás;
- A regional representative of IHF;
- A number of entrepreneurs invited by Minister Perry.

The meetings were held using **the 'Chatham House Rule'** - "When a meeting, or part thereof, is held under the Chatham House Rule, participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed."

All of the meetings dealt with SME credit in general but **a number of meetings were themed to specific sectors**, as follows:



The discussion at the meetings was based around a set of slides (see Appendix I) compiled by the Department of Finance which illustrated some of the key findings in the Mazars report, and contained questions to be addressed by stakeholders as to how various blockages in terms of viable SMEs obtaining credit could be addressed. **The Secretary General ensured that the meetings focused on the findings of the Mazars report.**

Meeting Notes and Action Points

The meetings were primarily a discussion to examine further the actions which might be taken to improve access to credit for SMEs. It was key, therefore, that during each discussion that "action points" were allocated for the stakeholders from each meeting. Many of the action points necessitate further work to be undertaken by stakeholders, including arranging follow up meetings and submitting material to the Department of Finance and/or the Department of Jobs, Enterprise and Innovation. The Department of Finance monitor these action points on an ongoing basis to ensure that the commitments made at the regional meetings are crystallised. A number of actions have already taken place, marked with a ✓.

These action points, preceded by a short synopsis of the individual meetings, are as follows:

Dundalk

This was the first of the regional meetings and was held on the morning of 3 February. The attendees included Senator Jim Darcy as well as the Presidents of Dundalk and Drogheda District Chambers. Some of the issues raised included how to consistently define a "viable business", the repercussions for struggling SMEs awaiting a decision on a credit application for more than 15 days from a bank, and how local second and third level students can provide a mentoring service for SMEs in terms of maintaining a business plan and cashflow projections. A key point observed during the meeting was the lack of knowledge of small businesses of the importance of cash flow planning. This was reflected in many loan applications and the fact that accounts for many businesses were just to be done after the fact for tax returns filing, and did not form an integral part of the management of the business.

- Dundalk/Drogheda Chambers to arrange meeting with banks and determine what local practice views as a "viable business" and send conclusions to D/Finance;

- Drogheda Chamber to revert with details of the "town bond" scheme and copy of their Drogheda & District Chamber Credit Demand Survey; ✓ *The town bond scheme details should assist in informing Government policy in the area of microfinance while the demand survey is a useful document to compare to the Mazars report on credit demand.*

- Issue of mentoring to be discussed at Chambers meetings; ✓

- Local banks to send data to Chambers re numbers of applications still pending and commit to addressing this issue;

- Chambers to examine how members could commit to microfinance fund and revert to Department of Finance;

- Attendees to submit credit suggestions to D/Finance;

- IFA to discuss with banks issue of borrower having to pay for bank's solicitor when land transactions are involved;

- Banks to visit customers on location to understand more about business. *Department of Finance to raise this issue in meetings with banks.*

- Chambers to reconvene group and meet on a monthly basis, and copy minutes to Department of Finance.

Dundalk post meeting actions:

- Local accountancy firms have expressed an interest in offering free mentoring services to SMEs, this is being facilitated by Dundalk Chamber; ✓

- Final year business students in Dundalk IT are undertaking a module in business planning and being encouraged to engage with local enterprises. ✓ *Two one week placements have been arranged between local businesses and Dundalk IT – the first in mid November and the second at the beginning of February, to fit in with tax return dates in Ireland and UK. This also gives firms the opportunity to identify potential recruits.*

Dublin

This meeting was held in the afternoon of 3 February and there was a large turnout. The heads of the business representative bodies were keen to point out that their members were in survival mode and focusing on the present rather than the future. The issues around overleveraged businesses in difficulty was discussed. Other issues raised included failing relationships between banks and businesses, and the importance of networking for SMEs.

- Issue of mentoring to be discussed at upcoming Chambers meetings – Fáilte Ireland to attend as they already run similar programme;

- ISME to invite Credit Review Office to meetings to raise awareness amongst members;

- Chambers to examine how members could contribute to microfinance fund and revert to Department of Finance;

- Attendees to submit credit suggestions to D/Finance;

- Secretary General to meet with ISME and SFA; ✓ *Sec Gen met separately the SFA and with an IEA/ISME delegation, who are to revert with a specific proposal regarding a new lending unit staffed by experts from various sectors with intimate knowledge of SMEs. He has since attended SFA and ISME events in order to connect with the membership.*

- The IBF to run a number of sessions on "preparation for the bank" throughout Ireland, which all SME representative bodies can support and attend.

Dublin post meeting actions:

- Laois Chamber due to host a meeting of banks and business community in the month following the Dublin meeting to reflect on issues of lending and commercial viability. ✓

- Following a suggestion at the Dublin meeting, the SME Credit Consultation Committee has been established, to be chaired by the Department of Finance. The role of this Committee will be to provide a structured forum meeting regularly where stakeholders can communicate and interact regarding difficulties in relation to SME credit with a view to proactively solving them. ✓

Cork

The Cork meeting was held on 27 February and took place directly before a large meeting on the Action Plan for Jobs involving four Government Ministers. It was the first meeting where we focused on a specific theme, in this case the technology sector. The attendees included representatives from Alpha Healthcare, IBM, IMDO, Kernel Capital and Cork IT.

The issues raised included the further need for more specific education in the banks on lending to IP companies, the fact that many software companies cannot access credit as they have no collateral at start-up, and the need for more angel investors in the sector. There was a greater positivity at the meeting regarding the attitude of banks towards loan applications and lending – perhaps suggesting that sectors specific to the region eg software and agriculture, are growth areas?

- CRO to arrange meeting with IFA and banks to raise awareness and to work on a more useful loan application; ✓ *CRO met with IFA and banks in Glanmire on 19 April. AIB stated that a new farming form is being developed which also indicates the type of additional info that will be required. The size of the credit request determines the amount of additional info required. The banks agreed that agriskills within the banks was higher years ago, and that steps are being taken to upskill staff.*

- Banks committed to visit customers on location to understand more about business;

- Attendees to submit credit suggestions to D/Finance.

Cork post meeting actions:

- CRO met with IFA and local banks – IFA to produce press release reminding members of the existence of the CRO. ✓
- In conjunction with the meeting, the Secretary General met with the CEO of Apple Ireland and discussed a number of relevant issues – including the importance of the technology sector to the region and relevant issues raised at the regional meetings. ✓

Waterford

This meeting was held on 28 February and the focus was on exports. Regrettably, no representative from the Irish Exporters Association was able to attend to give first hand experience. The attendees included representatives from Waterford and Clonmel chambers, the Centre for Enterprise Development and Regional Economy (CEDRE), and WIT School of Business.

The main issues arising included the requirement for assistance to SMEs looking to penetrate foreign markets, the need for a "one stop" website providing financial advice to SMEs, and the need for banks to be more flexible in terms of invoice discounting for foreign debtors and providing foreign exchange hedging products. The view was expressed that there was uncertainty about the right terms and conditions per sector. The level of knowledge regarding supports available for SMEs seemed low amongst the Chambers representatives present, which meant a lot of the actions were pointed in that direction. Also the fear factor for SMEs with regard to the future of the economy and their business was raised as a factor reducing demand.

- Waterford Chamber to arrange two information conferences – one re lending to growing businesses, and one re businesses in difficulty;

- IFA to discuss with local banks issue of borrower having to pay for bank's solicitor when land involved;

- Put info re incentives available to SMEs up on Department of Finance website; ✓ *The Department of Finance website now has a link to the Small Business Finance website:* www.smallbusinessfinance.ie

- Clonmel Chamber to work to establish rules regarding what documentation is required to accompany loan application forms to banks, as there is uncertainty as to what exactly is required and evidence that banks persist in requesting further documentation, which affect the response deadlines.

Waterford post meeting actions:

- The Secretary General had lunch at WIT with staff from the business school. As well as discussing the possibility of students from the business school mentoring local small businesses, he suggested that a prize winning research student could spend time working in the Department to do more targeted research on revitalising tor the region's businesses. ✓

- The viability of foreign banks cooperating with Irish pillar banks is being pursued by the Department of Finance in meetings in Europe and in China. ✓

Galway

The focus of this meeting, held on the morning of 9 March, was the tourism sector. Unfortunately representatives from the sector were unable to attend. Attendees included representatives from Údaras na Gaeltachta and Connaught Recycling.

The issues raised included some which had arisen previously such as the need for banks to visit business premises to get more of a "feel" for the company and the lack of general financial management infrastructure. There was also a sense that banks need to do more to inform customers of the SME Code of Conduct. There was also an interesting discussion around how bank customers might be encouraged to send a "better" set of accounts to the banks when applying for a loan eg a more transparent debate on cost of loans etc.

- Banks to send note to Department of Finance on linking pricing to submission of regular accounts;

- Banks to ensure inclusion of CRO reference on letters to SME customers who have been refused credit;

- CRO to produce more user-friendly brochure; ✓*Brochure has been produced and will be on display in relevant banks*

- Enterprise Ireland to arrange follow-up meetings to continue discussion and report to Department of Finance.

Galway post meeting actions:

- Enterprise Ireland & Galway County & City Enterprise Board following up with Bank of Ireland in relation to possible synergy during Bank of Ireland's Enterprise Week. ✓

Sligo

The meeting in Sligo took place on the afternoon of 9 March, with the issue of education and training for SMEs providing the key area of focus. The issues raised again included the possibility of linking the pricing of loans to the successful completion of a business course by the applicant, the general lack of confidence in bank staff to assess loan applications. To make it more available across the country and easier for businesses to access during "down time", the possibility of Sligo IT arranging online business planning courses for SMEs was discussed.

- Participants are committed to holding follow-up meetings. These will look at the possibilities of a bank provided voucher system;

- Enterprise Ireland and the banks will look at meeting clients in a similar manner in which they work together centrally;

- Enterprise Ireland will compile a list of possible local mentors willing to provide assistance;

- CRO committed to regional visits and will visit all of the regions this year; ✓ *The CRO continues to make presentations and man stands at relevant seminars and conferences in all regions, including Cork and Limerick.*

- Sligo IT investigating arranging online business planning courses.

Sligo post meeting actions:

- Sligo Chamber hosted a round table presentation in May on initiatives to facilitate access to finance for small businesses. ✓

Limerick

The final regional meeting was held in Limerick on 2 April and was very well attended, with the focus on the agriculture sector. The Minister for Finance, Michael Noonan T.D., addressed the meeting and reinforced the Government's commitment to ensuring that an adequate pool of credit is available to fund viable SMEs. Attendees included representatives from the IFA, Macra na Feirme, the SFA and the University of Limerick.

The issues raised included banks requesting very large collateral on loans to young farmers, who may have little collateral – the issue of chattel mortgages arose in this context. Other issues included banks insisting on personal guarantees and the difficulties of lending to a sector where there is such volatility of prices and high dependence on weather outcomes. The difficulties the hotel sector has in accessing non bank finance was also raised. There was also a query as to whether something might be done to reduce legal costs of transfers of mortgages to open up more competition in the agricultural sector.

- Limerick Chamber to host event for members on lending especially regarding role of CRO;

- AIB to bring out application form specific to agri sector by end May; *Department of Finance to raise issue with other banks.*

- AIB to revert to accountant on VAT query;

- Macre na Feirme commitment to participate in Kemmy Business School event.

- AIB to organise meeting with IFA and address concerns regarding credit application process;

- SFA to contact Sec Gen re invoice discounting issue;✓ *Secretary General met with HSBC who will provide the Department with a document outlining how it operates in terms of assisting businesses with export finance and invoice discounting*

- IFA to host regional meetings and invite the Law Society to discuss legal issues in relation to land transfer.

- IFA to examine what EIB might do for the agriculture sector.

Limerick post meeting actions:

- Limerick Chamber of Commerce and National Franchise Centre are having a day on funding, including the CRO; ✓

- UL hosted a follow up event with stakeholders in May, which was addressed by Minister for Small Business. ✓ *Some of the items on the agenda included addressing the disparity between information requirements of banks and some SMEs' ability to supply it and insights from the Credit Review Office on lending decisions by banks.*

- Department of Finance has engaged more proactively with the European Investment Bank (EIB) regarding greater participation in

The Credit Review Office

The Credit Review Office is here to help SME or Farm borrowers who have had an application for credit of up to €500K declined or reduced, and who feel that they have a viable business proposition.

The CRO will also look at cases where borrowers feel that the terms and conditions of their existing loan, or a new loan offer, are unfairly onerous or have been unreasonably changed to their detriment.

This is a strictly confidential process between a business, the Credit Review Office and the relevant bank. The Credit Review Office has tried to make this as process as simple as possible.

On reviewing the application, the Credit Review Office will provide the bank with an opinion on whether it agrees with the lending decision or not. The bank then responds to this opinion and confirms next steps in response to the recommendations set out by the Credit Review Office. In practice where the Credit Review Office has suggested the lending should be made, to date the banks have respected the opinion and complied. Where the Credit Review Office has upheld the banks' decision not to lend, the opinion will always seek to provide alternatives and guidance to the borrower to help the business move forward.

The **Relationship Frameworks** with the banks provide that the State will not intervene in the day-to-day operations of the banks or their management decisions including with respect to pricing and lending decisions. Therefore it is crucial that SMEs who have been refused credit from the banks avail of this independent service as the CRO is a key player in ensuring that viable businesses have access to credit.

Case Study of Credit Mediation (France)

As part of the follow up information gathering for the Department of Finance, the Secretary General met with the Irish Ambassador to France and two officials from the French Credit Review Office, Médiateur du Crédit.

Credit mediation was established in November 2008 in France to assist companies, in particular SMEs, to resolve their liquidity problems by maintaining or obtaining credit from financial institutions. It is headed by the National Credit Mediator who is responsible for the co-ordination the credit mediation system and also acts as the final referee in relation to appeals. The national credit mediator also produces regular reports informing government of the difficulties encountered by firms in accessing credit in order to enable the state to anticipate the risks and propose preventative measures.

Credit mediation operates though a network of 105 local mediators — departmental directors of the Banque de France and directors from the IEDOM and IEOM for the oversees territories — who work on a face-to-face basis with companies and financing partners at the departmental level. Both nationally and locally mediators are assisted by teams of analysts from the Public Finances Directorate General.

Like in Ireland, the local mediator's role is to help restore dialogue between the firm and the credit institution(s), to maintain or re-establish a relationship of trust between companies and their banks and to frame, through dialogue, solutions that reconcile the divergent positions of both parties. Mediation is not designed to penalise credit institutions but rather to provide concerted solutions that are tailored to individual's companies' particular profile.

Credit mediation operates through a combination of the existing decentralised state structures, state bodies and new networks of local assistances and has succeeded in fostering new synergies between public and private local economic actors. In this context credit mediation has been integrated into the broader policy framework for supporting economic activity and SME development at the departmental level.

From the outset local mediators have worked closely with the OSEO the government-backed SME development fund — to find financing solutions for companies seeking mediation. The OSEO's assistance in the form of bank loan guarantees makes it easier to accommodate both parties' needs and has also served to bolster the mediation process in many cases.

Similarly the mediation process is supported by a 1000 strong network of third party mediators drawn from an array of socio-professional organisations including trade associations, employers federations, business bodies and the order of chartered accountants. These experts work directly with companies prior to mediation and are also available to provide advice to a company throughout the mediation process and may also assist in the implementation of identified solutions.

The Credit Mediation service has also forged positive relationships with the banks, credit insurers and private equity funds as signified by the development of a number of memoranda of understanding that are designed to enhance the mediation process.

Since its establishment the remit of credit mediation has extended beyond the refusal of primarily short-term bank credit to companies per se, to include issues relating to the withdrawal of credit insurance cover and the treatment of firms equity financing needs. Overall, credit mediation in France has been viewed as a successful and innovative initiative and its effectiveness is largely attributable to enhanced co-operation between network of public and private actors.

- 59% of the companies seek mediation in relation to sums of less than €50,000.
- 95% of the companies who have engaged in mediation have less than 50 employees.
- The rate of successful mediation within 15 days of the process starting is 66%.

Aside from the direct impact on companies in terms of supporting growth and generating and/or saving employment, credit mediation has also contributed to individual economic players changing their behaviours and practices, enhanced levels of co-operation between public and private actors and smoother relationships between banks and their customers in what remains a difficult lending environment. These indirect effects are considered to be just as important in terms of stimulating economic development as statistical results of mediation.

The Department of Finance will shortly begin a review of operations of the Irish Credit Review Office. Among the issues to be addressed is to understand what drives the greater penetration of the Médiateur du Crédit in the French lending system. In France, population 65 million, at the end of October 2009, €1.6 bn had been released to 8,000 companies as a result of mediation saving an estimated 160,000 jobs. In his eighth quarterly report published on 5 June 2012, the Irish Credit Reviewer stated that the CRO has protected 683 jobs in Ireland, population 4.5 million, since its inception in April 2010, with almost €7m being released to 69 companies.

References:

Liebert, C. (2010) 'Credit Mediation', in *Banque de France, Quarterly Selection of Articles*, no. 16, Winter 2009-2010.

OECD (2009) The Impact of the Global Crisis on SME and Entrepreneurship Financing and Policy Responses, Paris: OECD;

Issues Raised

A number of similar themes and issues were identified at the regional meetings over and above the main ones raised in the demand survey. The issues that arose most frequently are set out below, with progress to date indicated by a "traffic light" key:

Challenging In progress Completed

Credit Review Office

a) Despite the success of the Credit Review Office (CRO), where it has ruled that credit be granted in over 50% of cases it has reviewed, public utilisation of the CRO remains very low if access to credit is so important to the survival or growth of businesses. There is a need to increase awareness of existence of the CRO;

b) Ensure that the CRO leaflet is more user-friendly and displayed more prominently in banks;

c) Ensure that banks notify customers who have been refused credit of their right to a review by the CRO – representatives from the three largest banks committed to ensuring this was the case at the Dundalk meeting.

a) An ongoing media campaign is focused on national and regional radio advertisements, which comprises a weeklong radio advertising burst each quarter at prime commuting time. In addition, print media advertising is used to leverage advertorial and editorial articles in selective national and regional newspapers and the business press. The publication of the CRO quarterly reports trigger further coverage. The Credit Reviewer has made himself available to meet with journalists for radio and press coverage, and speaks regularly at various business events. In addition, the CRO takes trade stands at many SME events and conferences. Following the regional meetings, the CRO have attended a meeting in Cork to discuss their role and addressed a conference in Limerick to provide an insight into lending decisions by banks.

The Action Plan for Jobs contains a commitment to assess the Credit Review Office to ensure SMEs are getting the support on bank lending they require.

b) The CRO have recently redesigned their leaflet to make it more user-friendly and informative. These new leaflets should be on display stands in all bank branches of the two pillar banks in the coming weeks.

c) The two pillar banks have agreed to ensure that all letters of rejection to eligible borrowers include the CRO leaflet.

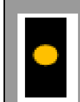
Banking sector

One of the issues facing the economy at the moment is the need for banks to lend to customers to generate business activity, but the actual stock of lending is falling. Do local branches need to be given more autonomy in relation to credit decisions? Branch managers have more of a "feel" for local businesses and can analyse credit applications with more knowledge of how a local business fits into the community.

In AIB, credit decisioning is available through individual discretionary limits held by staff, including the Branch Manager. These discretionary limits are distributed across the network based on staff individual competence and lending experience. For larger credit decisions the branch staff prepare the applications and submit the applications to a dedicated Credit Unit. The decision on the Credit application in these cases is signed off jointly between both the Credit Unit and the branch relationship manager ensuring that the local relationship manager has a role in all credit applications. Recently AIB increased the level of local discretion in its Commercial Banking Centres as part of a broader initiative to further enhance the flow of credit. A key area of focus for AIB is ongoing training initiatives to ensure that frontline staff are equipped to deal with their SME customers.

Bank of Ireland's operating model is based on the application being submitted and recommended by the local branch. The final credit decision is made by a centralised underwriting unit in Dublin, based on the information presented by the local Manager. Each application is assessed on an individual basis. The local branch recommendation is and remains a key factor in the process. There is also a robust appeals process available to Branch Managers and a central team within Business Banking regularly review credit applications and decisions to further ensure that Bank of Ireland is dealing appropriately with opportunities to grow its business.

This issue will be kept under review in the context of the Department of Finance's ongoing discussions with the banking industry and the Credit Review Office.



Banks are taking a disproportionate length of time to come to a decision on credit applications.

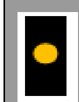
This view was borne out in the SME Lending Demand survey which found that 23% of credit applications were "pending." The Department of Finance met with the banks and raised this issue, which the banks committed to addressing. The results of the current SME Lending Demand survey will be available shortly which will indicate if this issue has been addressed by the banks. The Department will continue to pursue this issue until the figure reaches a satisfactory level.

When a decision on an application for review is not given by a bank within

15 working days, this shall be regarded as a constructive refusal and the borrower may appeal to the CRO. This issue was raised at a number of regional meetings and follow up meetings between the banks and representatives from various sectors have been arranged to discuss this issue further, including the exact documentation required for submission with a loan application.

Banks need to be more flexible in terms of lending to businesses with legacy property debts. Many viable businesses have difficulty accessing credit as they may have invested in property during the boom years and are now stuck with large mortgages which they have difficulty covering.
This is an issue of which the Department of Finance and Credit Review Office are acutely aware. It has been raised in quarterly meetings with the pillar banks and the Department are engaging continuously with the banks on this matter. If an otherwise viable business has difficulty servicing mortgage repayments, banks should be flexible and assist in devising a suitable repayment or alternative legal structures, such as splitting the loans to release the business from the pressure of property repayments until the business can recover. The Code of Conduct for Business Lending provides that for SMEs in financial difficulties, each SME needs to be considered on a case by case basis.

Education sector

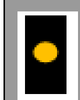
Local educational institutions should be more proactive in terms of offering assistance to small businesses in the locality.
As a result of the regional meeting in Dundalk, final year business students in Dundalk IT are planning to work in local businesses for two one week periods in November and February. Waterford IT are examining the possibility of a similar scheme for their business students. Sligo IT are investigating arranging online business planning courses. 

Government

SMEs need to have alternatives to the banks in terms of accessing credit.
The Action Plan for Jobs 2012 contains a commitment to “review the equity investment landscape in Ireland with a view to introducing actionable steps (enterprise supports, tax, etc) to support equity investment in productive firms.” The four key actors to deliver this are Forfás, the Department of Finance, Enterprise Ireland and the Department of Jobs, Enterprise & Innovation. The timeline for delivery of this action is Q3 2012, when recommendations will be presented to the Minister for Jobs, Enterprise & Innovation. Other sources of funds include County and City Enterprise Boards (CEB’s). These provide a range of financial supports designed to assist with the establishment and or growth of small scale businesses employing up to ten people. Supports available include feasibility/innovation grants, priming grants, business expansion grants, refundable aid, and equity investment options. The Action Plan for Jobs 2012 has committed to establishing a new “one-stop-shop” micro enterprise support structure through the dissolution

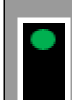
of the existing CEB offices and the creation of a new Micro Enterprise and Small Business Unit in Enterprise Ireland that will work with Local Authorities to establish a new network of Local Enterprise Offices (LEOs) in each Local Authority. The new LEOs will combine the enterprise support service of the previous CEBs and the business support work of the Business Support Units in the local authorities. A key role will be providing mentoring for micro-business.

SME Lending Funds of greater size than the microfinance fund are required to operate alongside equity start-ups, with leveraged funding from banks and the European Investment Bank alongside Government type seed funding.



More information on tools available for SMEs should be established, eg a website should be set up to provide guidance for SMEs in relation to cashflow management, credit options, Government supports etc.

Small Business Finance (www.smallbusinessfinance.ie), launched in February, is a website for businesses seeking information and guidance on how to finance their business. The Irish Banking Federation and Chambers Ireland have partnered to create Small Business Finance, a one-stop source for small businesses that provides access to all the information they need to finance their business. The website is a valuable, ongoing resource for all types of small businesses, including entrepreneurs, start-ups, established businesses and exporters. The Department of Finance website has a link to the Small Business Finance website. Other efforts need to be corralled to highlight this information.

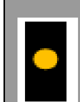


There should be a greater focus on mentoring services for SMEs, in particular microenterprises, in terms of drawing up business plans and cashflow projections.

The Action Plan on Jobs contains a commitment to reallocate up to €1.2 million per annum from the National Training Fund to fund management development networks and mentors for SMEs through Skillnets.

The Department of Jobs, Enterprise & Innovation have recently announced the creation of a "one-stop-shop " in the form of a Local Enterprise Office for the Micro-Enterprise and Small Business Sector in each Local Authority Area, with a staffing complement from both the CEBs and the Local Authorities, to be physically located in Local Authority offices delivering direct enterprise support and coordinating access to other services for business.

At the regional meetings the Secretary General challenged the relevant third level institutions and Chambers of Commerce to be more proactive in this area. As a result, there are initiatives in a number of regions whereby the local third level institution encourages students to interact with local SMEs to provide them with expertise on business planning and cashflow projections.



Issues for further consideration

The discussions at the regional meetings, while constructive, highlighted the fact that there are many questions still unanswered. The Department of Finance will continue to engage with stakeholders, for example through the SME Credit Consultation Committee, to address these issues. We encourage the submission of all ideas on the issues of SME credit, which can be mailed to secretarygeneral@finance.gov.ie. The ideas should not be restricted to, but may wish to consider, issues such as the following which we continue to progress.

(a) Credit Review Office

Why are the numbers availing of this service so small? The maximum charge is low at €250. The CRO has recommended that credit be granted in over 60% of cases it has reviewed. Are small businesses afraid of damaging their relationship with their bank manager if they appeal a credit decision? Are banks informing customers of the option of appealing to the CRO? Are business representative bodies informing their members of the existence of the CRO? Do the CRO need to increase their expenditure on advertising? Is the CRO viewed as being truly independent of the banking sector?

The Action Plan for Jobs contains a commitment to assess the Credit Review Office to ensure SMEs are getting the support on bank lending they require and these issues will be examined in this process.

(b) Agricultural Lending

Have banks the expertise and the right products to lend to young small farmers? Many of these individuals do not own property and as such cannot provide collateral for loans. Is there merit in the banks examining a chattel mortgage in these instances?

Also, with prices for agricultural products prone to fluctuate and the added unpredictability of the weather, do banks need to provide a new model for lending in this sector?

In March 2012, the Department of Finance hosted a meeting with the CEOs of the main lending banks and relevant stakeholders including the Irish Farmer's Association, the Irish Dairy Board, and the Department of Agriculture to discuss ways of improving lending in the agriculture sector.

Since the meeting the IFA and the IBF have engaged on ways to improve lending in the pig sector. The IFA submitted a paper to the IBF on the main issues affecting pig farmers. A number of banks have taken specific action to inform their branches of the particular credit issues in the pig sector and in some cases have communicated directly with their customers to encourage them to approach the banks.

(c) Hotels

A recent Fáilte Ireland report claims there is a distortion of the marketplace by NAMA and the so-called "bank-run" hotels – hotels to which banks have appointed receivers or where banks are closely involved in the operation of the hotel. These hotels are perceived to be under-cutting non-NAMA/bank-controlled hotels by offering uneconomic rates, and thereby putting smaller family run businesses under pressure.

Another issue for numerous hotels is that their lenders are winding down and not willing to supply credit.

Is there a need for Government intervention or would this distort the market further?

(d) Legacy debt

A number of stakeholders at the meetings raised the issue of legacy debt. This would relate to otherwise viable businesses who invested in property during the boom years and now have difficulty repaying the mortgage, which leads to problems obtaining credit.

Is there a case for banks to introduce "split mortgages"? Lenders could treat the mortgage separately and ensure that these businesses could build up working capital and grow – enabling them to deal with the mortgage debt at a later date.

(e) Non-bank finance

Basel III will require banks to hold 4.5% of common equity (up from 2% in Basel II) and 6% of Tier I capital (up from 4% in Basel II) of risk-weighted assets. Basel III also introduces additional capital buffers and liquidity requirements.

Given the ongoing tightening of regulatory requirements being placed on banks, **what can be done to create an environment which encourages a greater emphasis on non-bank forms of funding for the SME sector?**

Following consultation with the Department of Finance, the National Pensions Reserve Fund (NPRF) under the Strategic Investment Fund program is working on the development of a new SME Equity Fund, in which it will be a cornerstone investor, targeted at investing in small, medium and mid-sized businesses on the island of Ireland. It will be a traditional 10 year term private equity fund with a target capital raise of €250 - €350 million.